

October 14, 2011

The Honorable Julius Genachowski
Chairman
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

Re: In the Matter of Connect America Fund (WC Docket No. 10-90), A National Broadband Plan for Our Future (GN Docket No. 09-51), Establishing Just and Reasonable Rates for Local Exchange Carriers (WC Docket No. 07-135), High-Cost Universal Service Support (WC Docket No. 05-337), Developing an Unified Intercarrier Compensation Regime (CC Docket No. 01-92), Federal-State Joint Board on Universal Service (CC Docket No. 96-45) and Lifeline and Link-Up (WC Docket No. 03-109)

Dear Mr. Chairman:

In the course of reflecting on your remarks of Oct. 6 concerning the necessity of reforming the Universal Service Fund and the intercarrier compensation system, I became reacquainted with the controversy surrounding the application of access charges to prepaid calling card services.

In comments filed with the Commission on Apr. 18, 2011, a coalition of prepaid calling card providers including Cinco Telecom Corp., iBasis Retail, Inc., IDT Telecom, Inc., and STi PrePaid, LLC requested that the Commission act to resolve uncertainty over whether prepaid calling card providers purchasing local numbers from local exchange carriers are subject to a third party LEC's originating access charges. They note that for several years the Commission has failed to act on a petition that would clarify matters, which is a shame.

As I have written on the Discovery Institute's technology blog (see enclosure), I believe that this particular controversy perfectly illustrates the need for some of the reforms you are contemplating. It also highlights a serious problem you did not specifically mention in your remarks, i.e., the fact that USF and ICC force low-income Americans to subsidize telephone service for millionaires and other fortunate people. I look forward to reviewing how you will propose to structure a new Connect America Fund and a Mobility Fund to hopefully put an end to this inequity.

Sincerely,

/s/

Hance Haney
Senior Fellow and Director
Technology & Democracy Project
Discovery Institute

Enclosure

OCTOBER 11, 2011

Reforming Universal Service is Plan C for broadband regulation

Hance Haney

Chairman Julius Genachowski of the Federal Communications Commission spoke of the need to reduce subsidies for traditional wireline telephone service last week, as well as a perceived need for his agency to use the savings to subsidize broadband services (see the [press release](#) and the [text](#) of the speech).

Genachowski is absolutely correct about the need for reforming universal service and intercarrier compensation. Unfortunately, his determination to reform telephone subsidies is not for the purpose of generating consumer savings, but about redirecting resources currently at his disposal for the purpose of gaining some measure of control over unregulated broadband networks. Though cleverly disguised, this is actually a third major attempt to (slowly) impose public utility regulation on broadband service providers.

In his remarks, Genachowski eloquently described the disaster that universal service and intercarrier compensation have become.

[The Universal Service Fund] is wasteful and inefficient. The fund pays some companies almost \$2,000 a month - that's more than \$20,000 a year - for a single home phone line.

In many areas it subsidizes companies even though there is a competing provider-- typically a cable company--providing voice and broadband service without a dollar of government support.

In some places the program funds three or four overlapping networks.

Aside from the Universal Service Fund (USF), which enables the FCC to collect money from consumers and write checks to telephone companies, telephone company rate structures mandated by the FCC and most states contain hidden cross-subsidies. Genachowsky commendably wants to reform these, too.

Like USF, the current [intercarrier compensation (ICC)] system is unfair to American consumers: It forces hundreds of millions of consumers across the country to pay higher bills to subsidize monthly local telephone bills as low as \$8 for other consumers.

The current ICC system is also creating substantial uncertainty and widespread disputes-- which are being fought in courthouses and state commissions throughout the country--about the proper treatment of Voice over IP traffic for ICC purposes.

One wonders, how could the FCC have let things get so bad? Perhaps it is not easy for a government agency to resist the various reliance interests who thrive on waste and inefficiency.

Designed for the monopoly era, telephone subsidies are anticompetitive and unsustainable in today's marketplace. Try as the FCC and state public utility commissions might to protect USF and ICC by eliminating opportunities for arbitrage, enterprising vendors find ways to undercut artificially high prices mandated by regulators, providing relief to those consumers who pay higher bills to subsidize someone else's low monthly local telephone bill.

For example, in 2006 the FCC considered whether two types of "enhanced" prepaid calling card services should subsidize local wireline telephone service. In paragraph 1 of a confusing [declaratory ruling](#), the commission says "we will treat *certain* prepaid calling card service providers as telecommunications service providers" (emphasis added). In paragraph 10 of the same ruling, it says that "*all* prepaid calling card providers will now be treated as telecommunications service providers" (emphasis added). Paragraph 27 seems to impose the ICC subsidy obligation only on the two particular prepaid calling card services that gave rise to the declaratory ruling. A court in Texas is struggling to determine how to resolve this mess. (The case is *Southwestern Bell Telephone Company et al. v. IDT Telecom, Inc., et al.*)

For one thing, telephone subsidies, which require the urban poor to help subsidize telephone service for vacation homes in remote areas, are highly regressive. This is one reason why there is significant bipartisan recognition that USF and ICC are in urgent need of reform.

The prepaid calling cards at issue in the Texas litigation currently provide one means of escape, because they are not now contributing fully to a wasteful and inefficient system of telephone subsidies. And why should they? Prepaid calling cards have played a "vital role in providing telecommunications services to low-income consumers and members of the armed services," as the FCC acknowledges in paragraph 8 of the declaratory ruling. The cards are available without regard to credit history and give consumers unparalleled opportunity to control their expenditures for telecom services. Why, for example, should a person who has been downsized out of a job, is struggling to find in work in this awful recession and who relies on a prepaid calling card service to communicate with potential employers be forced to contribute to telephone subsidy mechanisms which the chairman of the FCC concedes are "wasteful and inefficient"?

Genachowski is on the right track in attempting to reform USF and the ICC system. However, he has failed to articulate why we should create a similar program (albeit with some refinements) for broadband. Why should we assume the FCC can design and administer a subsidy program for broadband that eliminates waste and inefficiency, or that will not discriminate against the urban poor?

Grand Design

Genachowski expressed his view (in the third paragraph of his remarks) that, "[h]arnessing the power of broadband Internet to benefit every American is at the core of this agency's mission." This debatable presumption is highly revealing of the chairman's true purpose.

Previous attempts to *harness* (i.e., regulate) broadband have not succeeded so far. The first attempt was rejected by the Supreme Court in [NCTA v. Brand X Internet Services](#) (2005). The second attempt was dealt a severe blow by the Court of Appeals for the D.C. Circuit in [Comcast v. FCC](#) (2010) and is also the subject of *Verizon v. FCC* (pending). The FCC's final network neutrality rules (see the [press release](#) and the [order](#)) are under review in *Verizon v. FCC*, and their fate is highly uncertain.

Genachowski's universal service remarks came on the same day the D.C. Circuit was randomly chosen to hear *Verizon v. FCC*. Many observers see this court as potentially one of the least sympathetic appellate forums for the FCC's net neutrality rules; indeed, net neutrality supporters worked hard though unsuccessfully to get the case heard somewhere else (see, e.g., [this](#) and [this](#)).

Genachowski made clear in his remarks (at paragraph 75) that "funding will be conditioned upon complying with rigorous obligations to serve the public and meet the goals of universal service."

Therefore, if the Court of Appeals rules that the FCC does not have jurisdiction to impose net neutrality rules, subsidies for broadband provide an opportunity for the FCC to immediately control a subset of broadband providers and possibly begin to "nudge" and eventually perhaps, in effect, regulate all broadband service providers through a back door.

As Phil Kerpen notes in Democracy Denied (2011),

It is easy to envision a scenario in which the Internet, transformed into a piece of public utility infrastructure, tightly regulated, and subsidized with billions of taxpayer dollars, would be subject to content restrictions to make sure certain voices are heard.

This perhaps explains the sudden urgency for reforming telephone subsidies (some ideologues view the Internet as a potentially ideal political organizing vehicle).

But the FCC has failed to make a compelling case that broadband subsidies are necessary at all as a result of robust private investment and constantly-improving technology. As the FCC itself concedes, the private sector is already investing vast sums on broadband networks.

Despite the difficult economy, the private sector continues to invest tens of billions of dollars in broadband infrastructure each year - \$65 billion in capital expenditures in 2010 alone - expanding capacity, increasing speeds on fixed networks and rolling out next-generation mobile services like 4G.

"In just six years, broadband deployment skyrocketed from reaching only 15 percent of Americans in 2003, to 95 percent by the end of 2009," according to Commissioner Robert M. McDowell.

Lawmakers should welcome and encourage common sense reforms of wasteful and inefficient telephone subsidies, but they ought to object to Genachowski's proposals for creating a "Connect America Fund" and a "Mobility Fund" for subsidizing broadband. It is quite possible that the private sector may be able to close the gap, sooner rather than later, without assistance from the FCC.